Specialization and Comparative Advantage

Read textbook P. 96-99 and the excerpt “New Ideas from Dead Economists”. Answer the following questions.

1. What insights about international trade came from Adam Smith and David Ricardo?

2. Think of a personal example similar to the one in the text of Chapter 5 where someone you know can perform many tasks better than others, but still should specialize in what he/she does best according to the principle of comparative advantage.

3. Does having an absolute advantage in producing both goods mean that you’re guaranteed to have a comparative advantage in both goods? Explain your answer.

4. The countries of East Fairfield and West Fairfield have the production possibilities tables for tobacco and corn shown below. Without trade East would produce at alternative C and West would produce alternative D. Note that the costs of producing tobacco and corn are constant in both countries.

# EAST FAIRFIELD PRODUCTION POSSIBILITIES TABLE

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| ***Product*** | ***Alternative*** | | | | | |
| **(lbs)** | **A** | **B** | **C** | **D** | **E** | **F** |
| Tobacco | 20 | 16 | 12 | 8 | 4 | 0 |
| Corn | 0 | 4 | 8 | 12 | 16 | 20 |

# WEST FAIRFIELD PRODUCTION POSSIBILITIES TABLE

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| ***Product*** | ***Alternative*** | | | | | |
| **(lbs)** | **A** | **B** | **C** | **D** | **E** | **F** |
| Tobacco | 15 | 12 | 9 | 6 | 3 | 0 |
| Corn | 0 | 5 | 10 | 15 | 20 | 25 |

A. Determine the ratio of production for each country

B. Which country has the comparative advantage in corn production and which country has the comparative advantage in tobacco production?

C If each nation specializes in the product where it has a comparative advantage and trades with the other, what will be the limits to the terms of trade for each tobacco unit?

D If the nations do not specialize and trade but remain at alternative C in East and D in West, the combined production of East and West Fairfield will be how much tobacco and how much corn?

E However, if the two nations specialize, the combined production of East and West Fairfield will be how much tobacco and how much corn?

F. What will be the total gain of tobacco and corn if the countries specialize and trade?